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November 16, 2005

Mr. Jack Davis
President and CEO
Arizona Public Service
400 East Van Buren
Phoenix, AZ 85004

Re: Arizona Public Service's under-funded pension liability plan; Docket No. E-01345A-05-0816.

Dear Mr. Davis:

As part of APS' application for a 20 percent increase filed at the Commission on November 4, APS revealed that Pinnacle West's pension plan is currently under-funded by \$389 million. Of this total, APS is requesting \$218 million, or \$44 million a year in this proceeding.

According to APS testimony, the under-funded pension's deficit is due to escalating medical costs and reduced interest rates, which have negatively impacted the performance of the pension fund investments.¹ While the Company's direct testimony on this issue states that the pension fund has been performing well,² the \$218 million deficit represents approximately 16 percent of the Company's total pension benefit obligation (PBO). The \$44 million annual revenue increase needed to correct the pension deficit appears to represent a full two percent of the Company's requested 20 percent rate increase. This appears to be roughly the same amount as the requested increase associated with the purchase of the Sundance power plant.

I am aware that it is early in the rate case process and that APS' application is under sufficiency review. I certainly have not reached any conclusions or opinions on the application or any matters raised in the application. I trust that in the rate case process the matters raised by the application will be fully investigated by the parties. However, because of APS' statements in its application concerning the under-funded pension plan, I am asking that APS docket responses to the following questions, so that the responses become a timely part of the record in this case.

- (1) Does APS have any plans to address the pension plan shortfall in the near term and is the under-funded liability currently being made up with shareholder funds?

¹ See Direct Testimony of Laura Rockenberger, pg. 23.

² Id.

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- (2) From a review of the Company's last rate case, it appears that APS did not raise the pension plan as a concern and did not ask for recovery of these funds at that time. That rate case concluded less than a year ago. Please explain how the pension plan came to have a \$44 million annual deficit so quickly and why the Company did not request these funds before now.
- (3) Please more thoroughly explain what factors led the pension plan to become underfunded and what steps the Company took and is taking to prevent this shortfall from occurring. Please detail the nature of the investments that make up the Company's pension plan and quantify, if possible, the fund administrator's performance when compared to other similarly situated pension funds.

Thank you for your timely attention to this matter.

Sincerely,



Kris Mayes
Commissioner

Cc: Docket Control
Ernest Johnson
Brian McNeil
Heather Murphy
Stephen Ahearn